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8	STATE	OF CALIFORNIA
9	NEW MOTO	OR VEHICLE BOARD
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11	In the Matter of the Protest of	Protest No. PR-2463-16
12	CALIFORNIA NEW CAR DEALERS	RESPONDENT JAGUAR LAND
13	ASSOCIATION Protestant,	ROVER NORTH AMERICA, LLC'S POST HEARING OPENING BRIEF
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15	V.	
16	JAGUAR LAND ROVER NORTH AMERICA, LLC,	
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HOGAN LOVELLS US LLP ATTORNEYS AT LAW LOS ANGELES	RESPONDENT JAGUAR LAND ROVER NOR	TH AMERICA, LLC'S POST HEARING OPENING BRIEF

I. INTRODUCTION

The California New Car Dealers Association (the "Association") filed the protest in this matter against Jaguar Land Rover North America, LLC ("JLRNA") challenging the legality of JLRNA's Amended Export Policy (the "Policy"). Under Vehicle Code § 3085, the Association has the burden of proving that the Policy violates Vehicle Code § 11713.3(y). As is discussed in detail below, the Association has not carried its burden of proof with respect to its substantive challenges to the Policy.

There is no dispute that JLRNA has a legitimate business interest in curbing the export of Jaguar and Land Rover vehicles from the United States. Indeed, the Association's own expert witness – Alan Skobin – testified both that it is a legitimate business goal for JLRNA to prevent exports and that dealers should not participate in activities that would result in vehicles being exported. Moreover, the parties stipulated at the hearing in this matter that the exporting of vehicles harms both dealers and JLRNA. As the testimony in this matter has established, there are numerous reasons why JLRNA (and other manufacturers) seek to prevent exports. For example, the exporting of vehicles outside the United States (i) undermines JLRNA systems established to ensure that the end user is on record for warranty and safety recall purposes and that customer satisfaction information and demographic data are collected; (ii) negatively impacts U.S. JLRNA dealers by, among other things, removing vehicles from the parts and service business, resulting in lost revenue in anticipated part sales and warranty work; and (iii) may impact future product allocation and vehicle pricing for U.S. retailers.

The Association nonetheless alleges that the Policy violates Vehicle Code § 11713.3(y) in three ways.

First, according to the Association, the Policy violates § 11713.3(y)(1), which makes it unlawful for JLRNA to "take or threaten to take any adverse action against a dealer" under the Policy unless "the dealer knew or reasonably should have known of the customer's intent to export" the vehicle(s) in question. The Association's challenge under § 11713.3(y)(1) largely focuses on three sentences in the Policy; namely, that (i) "[a] retailer exceeding its quarterly export threshold will now be selected for a Step 2 sales incentive audit of any and all of its sales

transactions;" (ii) "[t]he audit will include a review of the sales transactions for, among other things, compliance with this Amended Export Policy, the Contests and Incentives Standard Eligibility Rules for Retail Programs, and the Business Builder Program;" and (iii) "[a] retailer who fails to conduct an adequate level of due diligence in the sale to an exporter or broker is a violation of this Amended Export Policy." (Ex. J-1). According to the Association, these sentences violate § 11713.3(y)(1) because the Policy provides (i) that a Step 2 audit will be triggered by a dealer exceeding its quarterly export threshold; and (ii) that the audit is not limited to a review of "exported VINs," but includes a general audit of the dealers sales records for compliance with JLRNA's general contest and incentive rules. The Association also argues, without any evidence, that the Policy's "adequate level of due diligence" standard violates the statutory requirement that "the dealer knew or reasonably should have known of the customer's intent to export or resell the vehicle in violation" of the Policy. The Board should reject the Association's position for several reasons.

The Association's position entirely ignores and fails to account for the interplay between Vehicle Code § 11713.3(y)(1) and Vehicle Code § 3065.1(g)(1). Section 3065.1(g)(1) permits JLRNA to conduct audits of dealer incentive records on a reasonable basis, and for period of nine months after a claim is paid or credit issued, so long as the dealer is not selected for an audit and the audit is not conducted in a punitive, retaliatory, or unfairly discriminatory manner. The legislature simply could not have intended that JLRNA's exercise of its statutory audit rights under § 3065.1(g)(1) would place it violation of § 11713.3(y)(1).

Here, JLRNA's audits under the Policy comply with § 3065.1(g)(1) and the Association has introduced <u>no</u> evidence to the contrary. For example, JLRNA's audit manager, Michael Stern, testified that, given JLRNA's limited resources, not all dealers who exceed the export threshold will be audited. Moreover, JLRNA's audits would not be unreasonable even if all dealers who exceed the export threshold were, in fact, audited. JLRNA's national sales operations manager, Andrew Polsinelli, testified that JLRNA's 3% export threshold is standard practice in the luxury automotive industry. Further, Mr. Stern testified that, in the most recent quarter for which data was available, only 17 of 165 Land Rover dealers in the United States

exceeded the threshold (<u>i.e.</u>, approximately 90% of all Land Rover dealers were <u>below</u> the threshold). Staying below the 3% threshold is, thus, clearly achievable. That fact coupled with the fact that a 3% threshold is industry standard demonstrates that it would be reasonable for JLRNA to audit all dealers who exceed the threshold.

Additionally, JLRNA has a reasonable basis to audit transactions beyond the "exported VINs." Both Messrs. Polsinelli and Stern testified that JLRNA is unable to accurately capture a complete list of vehicles exported by a particular dealer. To determine whether there are other vehicles that may have been exported, therefore, JLRNA must audit more than simply the "exported VINs" it has identified for a particular dealer to determine if the dealer has violated the Policy and to what extent, if any. Further, owing to the JLRNA's limited audit resources and the fact that § 3065.1(g)(1) limits how often JLRNA may audit a particular dealer, it is entirely reasonable that JLRNA would audit more than "exported VINs" when it devotes its limited resources to audit a dealer. Finally, Mr. Stern testified that when conducting audits under the Policy JLRNA uses a "new or should have known" standard. In fact, Mr. Stern testified that he holds his auditors to an even higher standard; namely, that in order to find a dealer in violation of the Policy, the auditor must find "tangible" evidence in the form of a "smoking gun" that the dealer knew or should of known that the vehicle would be exported.

Second, the Association also argues that the Policy violates § 11713.3(y)(2), which makes it unlawful for the Policy to "include a provision that expressly or implicitly requires a dealer to make further inquiries into a customer's intent, identity, or financial ability to purchase or lease a vehicle based on any of the customer's characteristics listed or defined in Section 51 of the Civil Code." Section 51 of the Civil Code, which is known as the Unruh Act, prohibits discrimination based on various characteristics, including sex, race, religion, and national origin (the "Unruh Characteristics"). The Association alleges that the "Retailer Due Diligence and Best Practices" (the "Best Practices") and "Indicators of Potential Export or Broker Behavior" (the "Red Flags"), which are attached to the Policy, violate § 11713.3(y)(2). While the Association's expert witness, Alan Skobin, was critical of the practical application of the Best Practices and Red Flags it is notable that Mr. Skobin offered <u>no</u> testimony that the Best Practices or Red Flags implicate the

Unruh Characteristics in any way, let alone that the Policy requires dealers to "make further inquiries into a customer's intent, identity, or financial ability to purchase or lease a vehicle based on any of" the Unruh Characteristics.

Moreover, businesses have the right to exclude persons who would disrupt or interfere with their operations as long as the basis of the exclusion is not arbitrary. The Best Practices and Red Flags are not based on any of the characteristics in the Unruh Act and they are not arbitrary. They are intended to be applied equally to all persons, and are based not on the customer's status (e.g., national origin, citizenship, and immigration status) but on his or her individual conduct (e.g., history of exporting cars, using funds of a third party to purchase a vehicle, purchasing multiple motor vehicles over a short time period, and providing sales information that does not match the registration information on the purchased car). The Best Practices and Red Flags also serve a rational and legitimate business interest; namely, to identify potential exporters and their straw buyers and thus curb the exporting of motor vehicles intended for sale and operation in the United States.

Third, the Association alleges that the Policy violates Vehicle Code § 11713.3(y)(3) because it does not include a provision regarding the rebuttable presumption that arises in a dealer's favor under certain circumstances. JLRNA has agreed that the Policy must be amended to include the language required by § 11713.3(y)(3) and plans to do so once the Board rules on the Association's other challenges to the Policy.

JLRNA submits that the Policy does not violate Vehicle Code §§ 11713.3(y)(1) and (y)(2) and respectfully requests a ruling that the Association has not carried its burden of proof regarding JLRNA's alleged violation of those subsections.

II. STATEMENT OF FACTS

A. <u>JLRNA'S Export Policy</u>

The Policy was released to JLRNA's dealers on December 10, 2015, following the passage of Assembly Bill 1178¹ on October 6, 2015. (Exs. J-1 and R-211; RT² Vol. 1, 89:16-

Assembly Bill 1178 amended Vehicle Code § 11713.3(y) and granted the Association standing to file protests related to export policies under Vehicle Code § 3085. (Ex. R-211).

90:3). The Policy provides, among other things, that: (1) a dealer exceeding its quarterly export threshold of 3% of sales volume (for dealers at or above 250 annual vehicle sales) or 2 sales per quarter (for dealers below 250 annual vehicle sales) may be subject to a sales incentive audit of 25-35% of its sales transactions in the applicable period; and (2) dealers who are shown to have violated the policy after an audit are subject to various penalties, including a chargeback of all incentives paid to the dealer by JLRNA for such vehicle and certain penalties related to the allocation of future vehicles to the dealer. (Ex. J-1). JLRNA chose the 3% threshold by reviewing other industry export policies and determining that a 3% threshold is "typical of the luxury industry." (RT Vol. 1, 123:22-124:09). The 3% threshold is also reasonable in practice as only 17 of the approximately 165 Land Rover dealers in the United States exceeded the threshold in the most recent quarter for which data was available at the time of the hearing in this matter. (RT Vol. 2, 38:7-25).

Under the terms of JLRNA's prior export policy, a dealer would be automatically subject to chargeback if it exceeded its quarterly export threshold. (Ex. J-1; RT Vol. 1, 64:16-65:12). While JLRNA never enforced its prior export policy against any dealer, under the current Policy, as noted above, a dealer who exceeds its quarterly export threshold is not subject to any automatic penalties, but may be subject to an audit in compliance with California law. (Ex. J-1; RT Vol. 1, 64:16-65:12; Vol. 2, 14:9-12).

The Policy includes "Retailer Due Diligence and Best Practices" that JLRNA recommends, but does not require, dealers to follow in identifying potential exporters (the "Best Practices"). (Ex. J-1; RT Vol. 1, 92:19-93:22). Such Best Practices suggest that dealers, among other things, (1) compare the information provided by the customer and/or the leasing agent during the sales process (e.g., names, addresses, website data, and phone numbers) against various databases like the JLRNA Known Exporter List, other OEM known exporter lists, the JLRNA Sales History List, the Prospect Research Tool (the "PRT Tool"), and Carfax; (2) check

The Reporter's Transcript of Proceedings in this matter is referred to herein a "RT."

with financial institutions to confirm that the funding source matches the end-user customer; and (3) ensure that the information on the title registration and insurance of the new vehicle match the end-user and the information provided by that customer during the sales process. (Ex. J-1).

The Policy also includes a section titled "Indicators of Potential Export or Broker Behavior," which lists a number of red flags (the "Red Flags") that dealers "should recognize as having a high risk for being an export or broker transaction." (Ex. J-1). Red Flags include the customer purchasing a vehicle with a funding source from an unrelated payer or third party and the customer providing sales information that does not match the registration information on the new vehicle or the end-user. (Ex. J-1).

The Best Practices and the Red Flags were created at the request of, and in consultation with, JLRNA's dealers and are intended to apply equally to all persons. (RT Vol. 1, 92-19-93:22). Indeed, the Policy specifically states: "The Known Exporter List and the Prospect Research Tool are not intended to, and do not, restrict to whom a vehicle may be sold, which is subject to a retailer's discretion." (Ex. J-1).

B. <u>JLRNA Has a Legitimate Business Interest in Seeking to Curb Exporting</u>

JLRNA has a legitimate business interest in curbing the export of Jaguar and Land Rover vehicles from the United States. The Association's own expert witness – Alan Skobin – admitted that dealers should not participate in export activities and that the exporting of vehicles is "detrimental for a lot of reasons, both dealer and a factory and to the end customer." (RT Vol. 1, 140:11-18). Moreover, the parties have stipulated that vehicle exporting harms dealers and JLRNA alike. (RT Vol. 1, 129:07-130:19). As the testimony in this matter has established, there are numerous reasons why JLRNA (and other manufacturers) seek to prevent exports. For example, Mr. Polsinelli, testified that the exporting of vehicles outside the United States (i) undermines JLRNA systems established to ensure that the end user is on record for warranty and safety recall purposes and that customer satisfaction information and demographic data are collected; (ii) negatively impacts U.S. JLRNA dealers by, among other things, removing vehicles from the parts and service business, resulting in lost revenue in anticipated part sales and warranty work; and (iii) may impact future product allocation and vehicle pricing for U.S.

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C. JLRNA Provides Various Tools to Dealers to Help Identify Exporters

JLRNA provides dealers with various tools to help them identify exporters. Mr. Polsinelli described (i) the Known Export List compiled by JLRNA and published to all dealers, which lists customers who are known to have purchased vehicles and exported them from the United States (RT Vol. 1,75:08-75:11); (ii) the PRT Tool, which is a database designed and maintained by JLRNA which enables dealers to identify customers who have recently purchased, for example, multiple Land Rover vehicles at different dealers (which is a significant indicator that the customer may be an exporter) (RT Vol. 1, 91:07-92:10); and (iii) the Best Practices and Red Flags, which (i) dealers are not required to follow, (ii) JLRNA compiled with significant input from dealers, and (iii) provide dealers with the shared learnings of other dealers of ways to identify exporters (RT Vol. 1, 92:11-93:22, 96:19-97:16).

D. JLRNA's Audits Under the Policy are Reasonable and Lawful

Under the Policy, a dealer who exceeds its 3% quarterly export threshold is subject to a "Step 2 sales incentive audit." (Ex. J-1). Mr. Stern explained that pursuant to JLRNA's Sales Incentive Counseling Process policy, which is published to all Jaguar and Land Rover dealers, a Step 2 audit reviews 25-35% of a dealer's sales files. (Ex. J-4; RT Vol. 2, 10:9-11:12). A dealer who exceeds the threshold, however, is not automatically selected for an audit; in fact, not every dealer who exceeds the threshold will be audited as a consequence of exceeding the threshold. (RT Vol. 2, 14:9-12). Instead, Mr. Stern, testified that dealers are selected for an audit after a consideration of various factors that are not limited to issues related to exported vehicles. (Ex. J-4; RT Vol. 2, 13:15-16:24). To that end, JLRNA has "established an objective, risk-based approach to identify and select retailers for audits." (Ex. J-4). "Specifically, a model has been developed that measures objective criteria in order to rank retailers' potential risk level and noncompliance with" JLRNA incentive programs. (Ex. J-4).

Further, when JLRNA conducts a sales incentive audit, whether or not the dealer has exceeded its export threshold, it reviews 25-35% of the dealer's sales transactions in the applicable audit period. (Ex. J-4; RT Vol. 2, 23:2-5). Mr. Stern testified that there are several

reasons for this approach. First, JLRNA has limited audit resources. In particular, JLRNA has only three auditors who conduct sales audits, only one of whom is available full-time. (RT Vol. 2, 8:8-19). Mr. Stern also testified that JLRNA has approximately 365 Jaguar and Land Rover dealers in the United States and Canada for which his audit team is responsible. (RT Vol. 2, 8:20-9:3). Given the number of dealers in its network and the limited size of its audit staff, Mr. Stern explained that JLRNA can only conduct approximately 70-75 sales audits in total each year in the United States and Canada. (RT Vol. 2, 9:4-10). Consequently, when a Jaguar or Land Rover retailer is selected for audit, it is JLRNA's policy to conduct a general sales incentive audit regardless of what triggered the audit initially (e.g., an export violation). (RT Vol. 2, 23:2-5). Second, given its limited audit resources and limitations on the number of audits it can perform under applicable law, JLRNA's auditors "try to get a representative sample across all the various incentive programs so [JLRNA] can get a comfort level of compliance for the various incentive" programs. (Ex. J-4, RT Vol. 2, 14:9-16:24, 23:6-17). Third, even setting aside the resources issue, JLRNA does not limit its audit under the Policy to vehicles that JLRNA knows have been exported because JLRNA cannot reliably identify all vehicles that may have been sold by a particular dealer and later exported. (RT Vol. 1, 97:22-98:19, Vol. 2, 37:15-38:17). To determine whether a dealer has violated the Policy, therefore, JLRNA must review more than the sales transactions for vehicles it knows have been exported. (RT Vol. 2, 38:1-6).

JLRNA's audit process itself is also reasonable. After identifying a dealer for audit, the dealer will be sent an audit notification letter. (Ex. J-4). The assigned JLRNA auditor will then review the dealer's sales transactions to identify a representative sample of sales transactions to audit. (RT Vol. 2, 23:6-17). Once the JLRNA auditor has identified the sales transactions that will be reviewed, the auditor travels to the dealership to meet with the dealer and conduct the audit. (Ex. J-4; RT Vol. 2, 26:23-29:3). After reviewing the relevant sales transactions, the JLRNA auditor will review the findings of the audit with the dealer and the dealer is given an opportunity to appeal JLRNA's findings. (Ex. J-4, RT Vol. 2, 29:4-30:2).

The evidence in this matter also establishes that not a single California Jaguar or Land Rover dealer has been penalized under the Policy. Mr. Stern explained that JLRNA has

dealer under the Policy unless there is evidence that the dealer "knew or should have known" the vehicle would be exported at the time of sale. (RT Vol. 2, 43:10-18, 43:21-45:03, 87:21-88:16). In fact, Mr. Stern testified that he holds his auditors to an even higher standard; namely, that the auditor must find "tangible" evidence in the form of a "smoking gun" that the dealer knew or should have known the vehicle would be exported at the time of the sale. (RT Vol. 2, 43:21-45:3, 79:4-11, 81:13-82:16). JLRNA has not made such a finding regarding any dealer and has not penalized any dealer under the Policy. (RT Vol. 2, 43:10-18, 43:21-45:03, 87:21-88:16).

conducted a total of four audits in California under the Policy and that JLRNA will not penalize a

The four audits conducted in California did result in the dealers being charged back insignificant amounts. Indeed, the evidence shows that JLRNA paid those dealers a total over \$7 million (\$7,076,264.70) in incentives for the sales subject to audit and charged back the dealers a total of approximately \$18,500 (\$18,564.37) for undisputed violations of JLRNA's incentive program rules, none of which were for violations of the Policy. (Exs. J-6, J-10, J-14, J-20; RT Vol. 2, 41:22-42:8, 42:20-43:9, 45:23-46:21, 53:12-55:21, 56:10-58:12, 62:5-64:23, 65:12-67:12). That is a chargeback rate of less than three tenths of one percent. JLRNA's audits are not punitive fishing expeditions, but a reasonable exercise of JLRNA's rights under California law.

III. APPLICABLE VEHICLE CODE SECTIONS

A. <u>Vehicle Code Section 3085</u>

Vehicle Code § 3085, effective as of January 1, 2016, provides that an association, on behalf of two or more dealers subject to the export policy of an automobile manufacturer, may challenge that policy under § 11713.3(y) by filing a protest with the New Motor Vehicle Board (the "Board"):

- (a) An association may bring a protest challenging the legality of an export or sale-for-resale prohibition policy of a manufacturer, manufacturer branch, distributor, or distributor branch at any time on behalf of two or more dealers subject to the challenged policy pursuant to subdivision (y) of § 11713.3.
- (b) For the purpose of this article, an association is an organization primarily owned by, or comprised of, new motor vehicle dealers and that primarily represents the interests of dealers.

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(c) Relief for a protest pursuant to this section is limited to a declaration that an export or sale-for-resale prohibition policy of a manufacturer, manufacturer branch, distributor, or distributor branch violates the prohibitions of subdivision (y) of Section 11713.3. No monetary relief may be sought on behalf of the association or any dealers represented by the association.

(d) In a protest pursuant to this section, the association shall have the burden of proof to show that the challenged export or sale-for-resale prohibition policy violates subdivision (y) of Section 11713.3.

Cal. Veh. Code § 3085 (emphasis added).

B. Vehicle Code Section 11713.3(y)

Section 11713.3(y), which was amended effective January 1, 2016, prohibits an automobile manufacturer from doing any of the following, either directly or indirectly through an affiliate:

(y)(1) To take or threaten to take any adverse action against a dealer pursuant to an [export prohibition policy] because the dealer sold or leased a vehicle to a customer who either exported the vehicle to a foreign country or resold the vehicle in violation of the prohibition, unless ... the dealer knew or reasonably should have known of the customer's intent to export or resell the vehicle in violation of the prohibition.³

- (2) An [export prohibition policy] shall not include a provision that expressly or implicitly requires a dealer to make further inquiries into a customer's intent, identity, or financial ability to purchase or lease a vehicle based on any of the customer's characteristics listed or defined in Section 51 of the Civil Code. A policy that is in violation of this paragraph is void and unenforceable.
- (3) An [export prohibition policy] shall expressly include a provision stating the dealer's rebuttable presumption if the dealer causes the vehicle to be registered in this or any other state and collects or causes to be collected any applicable sales or use tax. A

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If, however, the dealer causes the vehicle to be registered in any state, and collects or causes to be collected any applicable sales or use tax due to California, a rebuttable presumption is established that the dealer did not have reason to know of the customer's intent to export or resell the vehicle. Furthermore, in any proceeding challenging the adverse action, the manufacturer has the burden of proof by a preponderance of the evidence to show that the vehicle was exported or resold in violation of an export prohibition policy and that the dealer knew or reasonably should have known of the customer's intent to export the vehicle to a foreign country at the time of the sale or lease. Id.

policy that is in violation of this paragraph is void and unenforceable.

Cal. Veh. Code § 11713.3(y).

C. Vehicle Code Section 3065.1(g)(1)

Section 3065.1(g)(1) governs incentive audits. It provides that:

Audits of franchisee incentive records may be conducted by the franchisor on a reasonable basis, and for a period of nine months after a claim is paid or credit issued. A franchisor shall not select a franchisee for an audit, or perform an audit, in a punitive, retaliatory, or unfairly discriminatory manner. A franchisor may conduct no more than one random audit of a franchisee in a ninemonth period. The franchisor's notification to the franchisee of any additional audit within a nine-month period shall be accompanied by written disclosure of the basis for that additional audit.

Cal. Veh. Code § 3065.1(g)(1).4

D. <u>Civil Code Section 51 – The Unruh Act</u>

The Unruh Act prohibits businesses from discriminating against any person based on certain characteristics:

- (a) This section shall be known, and may be cited, as the Unruh Civil Rights Act.
- (b) All persons within the jurisdiction of this state are free and equal, and no matter what their sex, race, color, religion, ancestry, national origin, disability, medical condition, genetic information, marital status, sexual orientation, citizenship, primary language, or immigration status are entitled to the full and equal accommodations, advantages, facilities, privileges, or services in all business establishments of every kind whatsoever.

Cal. Civ. Code § 51 (emphasis added).

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Section 3065.1 also contains detailed rights and remedies for dealers subject to incentive audits, including the requirement that the manufacturer have an internal appeal process before any chargeback is issued and granting the dealer the right to file a protest related to any proposed chargeback. See, e.g., Vehicle Code § 3065.1(g)(3) and (g)(5).

IV. ARGUMENT

A. The Audit Provisions Of The Policy Do Not Violate Section 11713.3(Y)(1)

As set noted above, the Association alleges that the Policy violates § 11713.3(y)(1) because it provides that "[a]ny retailer who exceeds its quarterly export threshold will now be selected for a Step 2 audit of its sales transactions, include but not limited to the exported VINs;" and that "[t]he audit will include a review of the sales transactions for, among other things, compliance with this Amended Export Policy, the Contests and Incentives Standard Eligibility Rules for Retail Programs, and the Business Builder Program." (Ex. J-1). The Association also argues that the Policy's "adequate due diligence" standard violates the statutory requirement that a dealer "knew or reasonably should have known" that the vehicle would be exported at the time of the retail sale. The Association's position is meritless.

First, Vehicle Code § 3065.1(g)(1) permits JLRNA to conduct audits of dealer incentive records on a <u>reasonable</u> basis, and for period of <u>nine</u> months after a claim is paid or credit issued, so long as the dealer is not selected for an audit and the audit is not being conducted in a punitive, retaliatory, or unfairly discriminatory manner. Manufacturers may also conduct at least one random audit every nine months:

Audits of franchisee incentive records <u>may be conducted</u> by the franchisor on a <u>reasonable</u> basis, and for a period of nine months after a claim is paid or credit issued. <u>A franchisor shall not select a franchisee for an audit, or perform an audit, in a punitive, retaliatory, or unfairly discriminatory manner. A franchisor may conduct no more than one random audit of a franchisee in a ninemonth period. The franchisor's notification to the franchisee of any additional audit within a nine-month period shall be accompanied by written disclosure of the basis for that additional audit.</u>

Cal. Veh. Code § 3065.1(g)(1) (emphasis added). Audits that are in compliance with these requirements cannot constitute the taking or the threatening of an adverse action under § 11713.3(y)(1). To read the respective statutes otherwise, as the Association suggests, would place JLRNA in violation of § 11713.3(y)(1) by exercising the audit rights granted to it in § 3065.1(g)(1).

The evidence in this matter establishes that audits under the Policy are conducted on a

HOGAN LOVELLS US LLP ATTORNEYS AT LAW LOS ANGELES reasonable basis and are not performed in a punitive, retaliatory, or unfairly discriminatory manner. See Section II.D., infra. JLRNA, has "an objective, risk-based approach to identify and select retailers for audits." See, e.g., Ex. J-4. "Specifically, a model has been developed that measures objective criteria in order to rank retailers' potential risk level and noncompliance with" JLRNA incentive programs. Id. All JLRNA dealers are subject to the terms of the Policy and JLRNA's audit rules. The audit, moreover, is not a "top to bottom audit" as the Association alleges as only 25% to 35% of the dealer's RDR's are reviewed pursuant to the Sale Incentive Counseling Process policy, which is published and made available to all dealers. Id. At the conclusion of the audit, a written report and summary of audit findings is presented to the dealer at a closing meeting. Finally, if the dealer disagrees with any of the audit findings, there is an appeal process. See, e.g., Ex. J-4.

Second, not all dealers are who exceed the 3% threshold are selected for an audit. Even so, it would be reasonable, and, therefore, allowed under § 3065.1(g)(1), for JLRNA to conduct an audit of all dealers who exceed the quarterly threshold. As is noted above, Mr. Polsinelli testified that the 3% threshold is "typical of the luxury industry" and, equally important, is a standard that the vast majority of Land Rover dealers do not exceed. In fact, in the most recent quarter only 17 of the approximately 165 Land Rover dealers in the United States exceeded the threshold, which means that approximately 90% of all Land Rover dealers did not exceed the threshold in that quarter. See Section II.D., infra.

Third, the Association's argument that the Policy is unlawful because JLRNA reviews "sales transactions for, among other things, compliance with this Amended Export Policy, the Contests Incentives Standard Eligibility Rules for Retail Programs, and the Business Builder Program," and audits more than the "exported VINs" it has previously identified regarding a particular dealer is similarly misplaced. Section 3065.1(g)(1) limits the frequency of JLRNA's audits (e.g., a "franchisor may conduct no more than one random audit of a franchisee in a ninemonth period"). Further, given its limited audit resources (e.g., JLRNA has only one full-time sales auditor and can complete a total of only 70-75 audits each year in the United States and Canada), JLRNA's auditors "try to get a representative sample across all the various incentive

programs so [JLRNA] can get a comfort level of compliance for the various incentive" programs when JLRNA choses a dealer for an audit. See Section II.D., infra. Third, JLRNA does not limit its audit under the Policy to vehicles that JLRNA knows have been exported because it cannot reliably identify all vehicles that may have been sold by a particular dealer and later exported. To determine whether a dealer has violated the Policy (and to what extent, if any), therefore, JLRNA must review more than the sales transactions for vehicles it knows have been exported. See Section II.D., infra. Nothing in § 11713.3(y)(1) prohibits JLRNA from conducting audits in compliance with § 3065.1(g)(1) whether those audits relate to "exported VINs" or otherwise.

Finally, the Association's argument that the "adequate level due diligence" standard violates the statutory "knew or reasonably should have known" standard is not supported by any evidence. Mr. Stern testified that when conducting audits under the Policy JLRNA uses a "new or should have known" standard. In fact, Mr. Stern testified that he holds his auditors to an even higher standard; namely, that in order to find a dealer in violation of the Policy, the auditor must find "tangible" evidence in the form of a "smoking gun" that the dealer knew or should of known that the vehicle would be exported. See Section II.D., infra.

JLRNA's audits under Policy are reasonable and comply with § 3065.1(g)(1). Such audits cannot form the basis of a finding that JLRNA has violated § 11713.3(y)(1).

B. The Policy Does Not Expressly Or Implicitly Require Dealers To Make Further Inquiries Into Unruh Characteristics

As set noted above, the Association alleges that the Policy explicitly or implicitly requires dealers to make <u>further</u> inquiries into the Unruh Characteristics. Those characteristics consist of the following: (1) sex; (2) race; (3) color; (4) religion; (5) ancestry; (6) national origin; (7) disability; (8) medical condition; (9) genetic information; (10) marital status; (11) sexual orientation; (12) citizenship; (13) primary language; and (14) immigration status. <u>See</u> Civil Code § 51. The Best Practices and the Red Flags described in the Policy, however, neither explicitly nor implicitly require such an inquiry.

First, dealers are not required to use the Best Practices or Red Flags; they are merely tools provided in consultation with and at the request of JLRNA's dealers. Second, the Policy does not

contain any specific references to any of the Unruh Characteristics. Third, California case law interpreting the Unruh Act, including whether certain conduct constitutes discrimination thereunder, provides guidance in determining whether the Association can satisfy its burden of proving that the Best Practices and the Red Flags <u>implicitly</u> require a dealer "to make further inquiries into a customer's intent, identity, or financial ability" based on any of the Unruh Characteristics.

The Unruh Act prohibits discrimination based both on the Unruh Characteristics and on any other arbitrary discrimination by business establishments. Marina Point, Ltd. v. Wolfson, 30 Cal.3d 721, 731 (1982) (Unruh Act covers a wide range of discriminatory practices such as policies against students, welfare recipients, those of a particular occupation or marital status, and children). "The overriding issue is always whether the denial of access to public accommodation is based on race, sex, religion or other arbitrary and unjustified grounds." Wynn v. Monterey Club, 111 Cal. App.3d 789, 796-798 (1980). To state a cause of action for a violation of the Unruh Act, the plaintiff must prove that the discrimination was intentional. Harris v. Capital Growth Investors XIV, 52 Cal. 3d 1142, 1170, 1175 (1991).

Nevertheless, not all discrimination is barred by the Unruh Act. Discrimination that is based on individual conduct and economic criteria is not barred as long as it is reasonable and made in furtherance of a legitimate business interest (i.e., not arbitrary). See, e.g., Harris, 52 Cal.3d at 1161-1162; Hubert v. Williams, 133 Cal.App.3d Supp. 1, 3-4 (1982) (excluding certain people from a business is not prohibited by the Unruh Act if it the exclusion is reasonably based upon the individual conduct of the person who is excluded). Indeed, "an entrepreneur need not tolerate customers who damage property, injure others or otherwise disrupt his business." O'Connor v. Village Green Owners Assn., 33 Cal.3d 790, 794 (1983); see also Frantz v. Blackwell, 189 Cal.App.3d 91, 95-96 (1987) (a real estate developer could refuse to sell a lot to an individual known to be an investor/speculator because the developer did not want someone taking "parasitical advantage" of his skills and effort).

Here, the Best Practices and the Red Flags do not explicitly reference any of the Unruh Characteristics (e.g., sex, race, color, religion, national origin, citizenship, immigration status,

etc.). Furthermore, they are not implicitly based on any of the Unruh Characteristics. They are intended to be applied equally to all persons and are based not on status but on conduct (e.g., history of exporting cars, using funds of a third party to purchase a vehicle, purchasing multiple motor vehicles over a short time period, and providing sales information that does not match the registration information on the purchased car). They also serve a rational and legitimate business interest; namely, to identify potential exporters and their straw buyers and thus curb the exporting of motor vehicles intended for sale and operation in the U.S.

The Association's only "evidence" that the Policy requires dealers to make "further inquiries" into facts relating to the Unruh Characteristics consists of the opinions offered by Mr. Skobin. In that regard, Mr. Skobin testified that, while the Policy specifically states that the Best Practices and Red Flags are "recommendations" and are "retailer observations and learnings that JLRNA is sharing with the retailer network," in his opinion "in real life" a dealer would consider the Best Practices and Red Flags as "mandatory." RT Vol. 1, 149;17-150:19. He also testified with reference to the Best Practices and Red Flags that "[r]equiring further steps over the already burdensome steps [a dealer takes to vet customers] is unduly burdensome and disruptive" and that the Best Practices and Red Flags "are not realistic or practical in the sales process environment ... 'unless there is cause for suspicion.'" RT Vol. 1, 154:3-9 and 157:15-158:7. JLRNA, of course, disputes that the Best Practices and Red Flags are mandatory or impractical "in real life." Indeed, the Policy and Mr. Polsinelli's testimony establish that the Best Practices and Red Flags are "recommendations" that came from the "real life" experience and learnings of other dealers. But more importantly, whether the Best Practices and Red Flags are mandatory or whether they are "burdensome" or "not realistic or practical," is wholly irrelevant to this matter. The only fact that matters regarding whether the Policy violates § 11713.3(y)(2) is whether the Policy requires dealers to "make further inquiries into a customer's intent, identity, or financial ability to purchase or lease a vehicle based on any of" the Unruh Characteristics. The Association has failed to introduce any evidence, whether through Mr. Skobin or otherwise, that the Best Practices or Red Flags touch on the Unruh Characteristics in any way. Consequently, the Association has not carried its burden to prove that the Policy violates § 11713.3(y)(2).

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C. A Finding that the Policy is "Implicitly" Unlawful Would Be Unconstitutional

Section 11713.3(y)(2) is unconstitutionally vague because it is not sufficiently clear what it means for a provision in an export or sale-for-resale prohibition policy to "implicitly require[] a dealer to make" discriminatory inquiries.

The U.S. Constitution's Due Process Clause requires that people be given "fair notice" as to what conduct is subject to government sanction. FCC v. Fox Television Stations, Inc., 132 S. Ct. 2307, 2317 (2012). A law is unconstitutionally vague if it "fails to provide a person of ordinary intelligence fair notice of what is prohibited, or is so standardless that it authorizes or encourages seriously discriminatory enforcement." Id.

A finding in this case by the Board that JLRNA violated California law because the Policy violates the prohibition on "implicitly" requiring dealers to make inquiries into Unruh Characteristics would be impermissibly vague, and thus a violation of the Due Process Clause of the Fourteenth Amendment to the U.S. Constitution, because it is impossible for JLRNA to determine when a policy "implicitly" requires a dealer to make a proscribed inquiry.

V. CONCLUSION

For each of the reasons discussed above, JLRNA respectfully submits that the Association's challenge to the Policy under Vehicle Code §§ 11713.3(y)(1) and (y)(2) should be rejected.

Date: March 13, 2017

HOGAN LOVELLS US LLP

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ATTORNEYS AT LAW LOS ANGELES

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1	PROOF OF SERVICE	
2	STATE OF CALIFORNIA)) ss.	
3	COUNTY OF LOS ANGELES)	
4 5	I am employed in the County of Los Angeles, State of California. I am over the age of eighteen and not a party to this action. My business address is Hogan Lovells US LLP, 1999 Avenue of the Stars, Suite 1400, Los Angeles, CA 90067.	
6 7	On March 13, 2017, I caused the foregoing document described as: RESPONDENT JAGUAR LAND ROVER NORTH AMERICA, LLC'S POST HEARING OPENING BRIEF to be served on the interested parties in this action as follows:	
8	Halbert B. Rasmussen Arent Fox LLP 555 West Fifth Street	
10	48 th Floor	
11	Los Angeles, CA 90013 213-629-7400	
12	E-mail: halbert.rasmussen@arentfox.com	
13	New Motor Vehicle Board	
14	1507 – 21st Street, Suite 330 Sacramento, CA 95811	
15	916-445-1888	
16	E-mail: nmvb@nmvb.ca.gov	
17	[X] BY MAIL. I sealed said envelope and placed it for collection and mailing following ordinary business practices.	
18	[X] BY E-MAIL. I served such document(s) in PDF format to the e-mail address(es)	
19	indicated above following ordinary business practices.	
20	[X] (State) I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.	
21	foregoing is true and correct.	
22	Executed on March 13, 2017, at Los Angeles, California.	
23	Ph. Mar	
24	Colm A. Moran	
25	Printed Name Signature	
26		
27		
28		
HOGAN LOVELLS US LLP ATTORNEYS AT LAW	18	
LOS ANGELES		

RESPONDENT JAGUAR LAND ROVER NORTH AMERICA, LLC'S POST HEARING OPENING BRIEF